

## Internal Revenue Service

Department of the Treasury  
Washington, DC 20224

Number: **202009022**

Release Date: 2/28/2020

Index Number: 1361.00-00, 1361.01-02,  
1361.03-00, 1361.03-03,  
1362.00-00, 1362.04-00

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B03  
PLR-116913-19

Date:  
November 25, 2019

## LEGEND

X:

Trust:

A:

D1:

D2:

D3:

D4:

D5:

State:

Dear :

This letter responds to a letter dated July 16, 2019, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code (the Code).

## FACTS

According to the information submitted and representations made, X was formed on D1 as a corporation under the laws of State. Effective D2, X elected to be treated as an S corporation. Prior to D3, Trust, a shareholder of X, was a grantor trust that was treated (under subpart E, part I of subchapter J of chapter 1) as owned by A. On D3, the terms of Trust were modified such that Trust ceased to be a grantor trust.

X represents that as of D3, Trust satisfied the Electing Small Business Trust (ESBT) requirements within the meaning of § 1361(e), but that the trustee of Trust failed to make an election under section 1361(e)(3) of the Code. Therefore, X's S corporation election terminated on D3.

X and the trustee of Trust represent that Trust does not have a power described in § 1.1361-1(m)(4)(vi)(B). X also represents that, other than the failure to make valid an ESBT election on D3, X qualified as a small business corporation at all times since its election on D2. X represents that X and its shareholders treated X as an S corporation. X filed its income tax returns consistent with having a valid S election in effect for all taxable years since D2 and that Trust filed its tax returns as an ESBT for the period from D4 through D5.

X further represents that its S corporation election termination was inadvertent and not motivated by tax avoidance or retroactive tax planning. X represents that X and its shareholders agree to make any adjustments required as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f) that may be required by the Secretary.

#### LAW

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(c)(2)(A)(v) provides that for purposes of section 1361(b)(1)(B), an ESBT may be a permissible S corporation shareholder.

Section 1361(e)(1)(A) provides that the term "electing small business trust" means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in paragraph (2), (3), (4), or (5) of § 170(c), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(1)(B) provides that the term “electing small business trust” shall not include (i) any qualified subchapter S trust (as defined in § 1361(d)(3)) if an election under § 1361(d)(2) applies to any corporation the stock of which is held by such trust, (ii) any trust exempt from tax under subtitle A, and (iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in § 664(d)).

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) provides that the trustee of an ESBT must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii).

Section 1.1361-1(m)(2)(iii) provides that the trustee of an ESBT must file the ESBT election within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a qualified subchapter S trust election (generally within the 15-day-and-2-month period beginning on the day that the stock is transferred to the trust).

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination under § 1362(d)(2)(A) is effective on and after the date of cessation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

### CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that the failure of Trust to file an ESBT election effective D3 caused an inadvertent

termination of X's S corporation election within the meaning of § 1362(f) on D3. Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation beginning on and after D3, unless X's S corporation election is otherwise terminated under § 1362(d).

This letter ruling is contingent upon the filing of an ESBT election within one hundred-twenty (120) days from the date of this letter effective D3 for Trust with the appropriate service center. A copy of this letter should be attached to the ESBT election. If this condition is not met, then this ruling is null and void. Furthermore, if this condition is not met, X must send notification that its S election has terminated to the service center with which X's S election was filed.

Except for the specific ruling above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by the appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter ruling to your authorized representative.

Sincerely,

Adrienne M. Mikolashek  
Branch Chief, Branch 3  
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter  
Copy of this letter for § 6110 purposes

cc: